Supreme Court, U.S.
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No. 02-695

In the
SUPREME COURT OF THE UNITED STATES

MICHAEL FITZGERALD,
Treasurer of Iowa,

Petitioner,

v.

RACING ASSOCIATION OF CENTRAL IOWA,

Respondent.

BRIEF *AMICI CURIAE* OF THE STATES OF MISSOURI, ALABAMA, MICHIGAN, MINNESOTA, MISSISSIPPI, NEW MEXICO, SOUTH DAKOTA, TENNESSEE, VERMONT, COMMONWEALTH OF PUERTO RICO

IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

Can a state tax revenue at different rates, when that revenue is derived from similar activities by distinct segments of an industry at different types of locations, without violating the Equal Protection Clause?

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In Support of Petitioner

INTEREST OF AMICUS CURIAE

The amici are the attorneys general of their respective states and commonwealths, responsible for defending legislative enactments – including laws raising revenue – and the actions of state officials – including the collection of taxes. Their interest in ensuring that legislatures have the ability to allocate the burdens of government without undue interference is heightened, at this time, by the financial conditions of many states. The National Governor's Association recently reported:

> Nearly every state is in fiscal crisis. Amid a slowing growing national economy, state revenues have shrunk at the same time that spending pressures are mounting–particularly for Medicaid and other healthcare–creating massive budget shortfalls.[1]

In that environment, legislatures need the maximum flexibility constitutionally allowed to tailor not just the expenditure of funds, but the methods of raising funds. Tax rates and revenues and economic success are closely tied. Success in a particular area or a particular industry enables higher taxes there to raise additional revenue. Lack of success in a particular area or a particular industry lowers revenue. Lower taxes for a particular area or a particular industry may, by reducing costs, enhance economic success – leading, in turn, to higher revenues.

The Iowa Supreme Court's holding threatens the States' ability to work effectively in today's difficult economic world. The holding threatens the state legislatures' ability to promote economic development in an orderly fashion – *i.e.*, free of undue second-guessing from the courts. And that threat extends not just to the setting of tax rates up front, the particular matter at issue here, but to the use of tax credits – means by which legislatures retroactively reduce effective tax rates, often for selected categories of businesses. The Iowa Supreme Court's decision, if affirmed, will permit courts to replace legislatures as the experts on these and related questions of taxation and economic development.

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[1] THE FISCAL SURVEY OF THE STATES (National Governors Association, November 2002) at viii (available on Feb. 4, 2003, at http://www.nga.org).

SUMMARY OF ARGUMENT

"The tax system in the United States is a major vehicle of social and economic policy."[2] This case tests the authority of the courts, invoking the Constitution of the United States, to second-guess the legislative development of tax systems that are, in fact, vehicles of economic policy. Specifically, it addresses tax systems that raise revenue in a manner that targets benefits to geographic areas that are seeing little economic success.

The Iowa court belittles geographic differentiation. It does so in the context of a tax that sets one tax rate for an activity when it is undertaken by one segment of an industry, and another, higher rate for similar activities undertaken by another segment of perhaps the same industry. Those segments, largely as a result of state regulation, are distinguished by geographic location. If endorsed by this Court, the Iowa court's refusal to defer to legislative reliance on geographic distinctions would threaten elements of the tax systems other than differential rates. States also have entire taxes that apply – or, at local option, are available to be applied – only to specific geographic areas. And they have created tax credit schemes available only to businesses that operate in carefully defined geographic areas.

The courts do not have the economic expertise to second-guess such legislative determinations. And until the Iowa court's decision, the courts stayed out of such debates. This court should rein in the constitutional doctrine advocated by the Iowa court and retain for the legislative branch the ability

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[2] Leo P. Martinez, *Of Fairness and Might: The Limits of Sovereign Power to Tax After Winstar*, 28 ARIZ. ST. L. J. 1193, 1200 (Winter 1996).

to effectively tailor tax policy to address economic inequities within the States.

ARGUMENT

I. Uneven economic development and economic opportunity require that legislatures differentiate among industries and locations.

In no state is economic success uniform in all areas. Rather, the ebb and flow of the economy benefits some areas while leaving others behind. "Dating back to colonial times, some industries have been favored over others and some areas have grown faster than others."[3] The "pattern of industrial and geographical development has changed significantly over time."[4] Geographically, urban areas may have the strongest economies for a time, but that distinction may then pass temporarily to smaller towns or some rural areas.[5] Some areas, however, seem to have persistent economic problems.[6]

State legislatures have various tools for targeting assistance to the areas and industries in greatest need. Those seeking to help disadvantaged areas point legislators to the

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[3] Robert. Q. Hanham & Alison Chisholm Hanham, *The Uneven Development of Manufacturing in the Southeast, 1950-1990*, 41 SOUTHEASTERN GEOGRAPHER 1 (May 2001).

[4] *Id.*

[5] *Id.* at 11.

[6] *See, e.g.*, Thomas A. Lyson & William W. Felk, FORGOTTEN PLACES: UNEVEN DEVELOPMENT IN RURAL AMERICA (U. Press of Kansas, 1993).

obvious connection between government fiscal policies and localized development. For example, the Center for Public Policy Priorities, looking at economic development and state economic policies – including tax policies – in Texas concluded:

> The uneven economic health of communities across Texas is important in examining public economic development activities. Federal, state, and local governments directly and indirectly influence the economic development of communities through programs and tax expenditures. As long as a significant share of the state's communities lack the resources to participate fully in an expanding economy, the continued use of public resources for economic development is legitimate and needed.[7]

Though grants and other expenditures are the most obvious means of making "public resources [available] for economic development," tax policies also result in the movement of "public resources" into targeted areas.

Iowa chose to enhance economic development by permitting certain kinds of gambling. In the case of casino gambling, Iowa permitted it only in a targeted area, *i.e.*, in river towns where there was an economic need. By bringing back an image of the golden era of river travel, Iowa sought to enhance the river regions' attractiveness to tourists. Iowa also permitted betting at horse and dog tracks. Then, when the tracks fell on hard economic times, Iowa allowed them to add slot machine gambling.

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[7] "Texas Economic Development Incentives: for the Common Good?" (Feb. 11, 2000), available February 14, 2003, at http://www.cppp.org/products/policypages.

The Iowa legislature, in determining how to tax those different segments of the gambling industry, permitted to operate only in certain geographic areas, made economic choices. It told the tracks that although they could offer slot machines, it was not going to treat all of that revenue as if the tracks were casinos. The Iowa legislature thus used tax policy to protect its efforts to enhance economic development along the rivers from a threat that might be posed by slot machine gambling at the tracks.

II. Legislatures commonly make distinctions based on geography as they seek to promote and preserve economic development.

In this particular instance, Iowa has established two taxes, reaching similar activities, but in two distinct segments of what may be the same industry, segments that are permitted to operate only in two different types of locations. In judicially modifying the higher of the two taxes, the Iowa Supreme Court derogated the State's ability to differentiate geographically when establishing taxes. But geographical distinctions are common – and, indeed essential. They recognize the economic differentials discussed above.

Those differentials affect the setting of tax rates in two respects. Industries in areas that are well-off are better able to bear the burdens of taxation. And lower taxes give industries an incentive to locate in disadvantaged areas. Legislatures seeking to fund government services will thus adopt taxes and tax rates that raise more revenue from wealthy than from poor areas. And they will adopt taxes and tax rates that give benefits to those who locate, relocate, or expand in poor areas. Their ability to do so would be threatened by a decision affirming the holding of the Iowa Supreme Court.

A. Special taxes may be imposed by a state only on those in a particular geographic area.

Iowa's distinction between boats operating in river towns and tracks located elsewhere is only one example of the myriad ways in which states differentiate geographically when establishing tax schemes.

State taxes may apply only to particular counties. For example, Utah permits only rural counties to impose a tax up to 1% to fund rural county health care facilities and rural hospitals.[8] Alabama has a transient occupancy tax of 5% for counties located in the Alabama mountain lakes area, and 4% for all other counties.[9]

The geographic area need not be a county. Connecticut taxes the handle at dog tracks at 2%,[10] but taxes off track betting at 3.5%.[11] New York caps locally imposed taxes on admissions to harness or running races at 3%, but only if the regional corporation has an off-track betting facility.[12] In Utah, resort communities may impose an additional fixed percentage sales tax.[13] And at least half of the states have enacted a variety of

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[8] UTAH CODE ANN. §59-12-802 (2003).

[9] ALA. CODE, §40-26-1 (2002).

[10] CONN. GEN. STAT. §12-575(e) (2002).

[11] *Id.* §12-575(g).

[12] NY CLS RACING & WAGERING §531 (2002).

[13] UTAH CODE ANN. §59-12-401 (2003).

tax statutes that are simply based on the population of geographically defined subdivisions.[14]

The states have also created thousands of independent public authorities and special districts. These local governments are entrusted with the power to provide basic public services, and authorized to pay for them by imposing local taxes, which they do at widely disparate rates.[15] An obvious example is schools. The States' provision of their respective educational systems is generally geographically based: States delegate much of the decision making authority to local school districts, and most states rely primarily on local property taxes for school funding.[16] But the local taxing authorities take a variety of other forms. Florida permits the formation of regional transportation authorities, which may be authorized by their voters to levy an ad valorem tax on the value of real property.[17] In Indiana, a certified technology park has authority to levy property taxes in the geographic area where the park is

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[14] Validity of Statutory Classifications Based on Population – Tax Statutes, 98 A.L.R.3d 1083 (1980)(table of jurisdictions represented).

[15] R. Biffault, *Our Localism: Part I – The Structure of Local Government Law*, 90 COLUM. L. REV. 1, 19 (1990), and R. Biffault, Our Localism: Part II – Localism and Legal Theory, 90 COLUM. L. REV. 346, 375-378 (1990).

[16] Quentin A. Palfrey, *The State Judiciary's Role in Fulfilling Brown's Promise*, 8 MICH. J. RACE & L. 1, 7-9 (Fall 2002).

[17] FLA. STAT. §163.570 (2002).

located.[18] And Washington authorizes the formation of multi-county hospital districts that have the power to levy taxes.[19]

Some – though not all – of these tax laws can be distinguished from the Iowa tax because the benefits flow to the area where the tax is imposed. But each law taxes similar activities at different rates, using the sort of geographic criteria the Iowa court disparages. The ability of legislatures to make such geographic distinctions would be inhibited, were the Iowa Supreme Court right in concluding that courts can easily second-guess them. And were the Iowa holding applied to declare existing, geographically-defined taxes unconstitutional and require refunds, the States' already gloomy financial picture would suddenly become even more bleak.

B. Tax credits available only in certain areas, such as "enterprise zones," modify tax rates for a particular geographic area.

States do not restrict their geographic differentials in taxation to different taxes or tax rates, such as those discussed above. They also use tax credits and other targeted incentives to "focus economic development policy on poorer areas."[20] Perhaps most universal are "enterprise zones." Such zones have recently "become a central pillar of many states' economic

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[18] IND. CODE ANN. §36-7-32-15 (2002).

[19] WASH. REV. CODE § 70.44.060 (2002).

[20] Alan H. Peters & Peter S. Fisher, "The Effectiveness of Enterprise Zones," Employment Research – October 2002, W.E. Upjohn Institute for Employment Research, available Feb. 14, 2003 at http://www.upjohninst.org/publications/.

development effort."[21] "[E]nterprise zone programs consist mainly of tax instruments: property tax abatements, sales tax exemptions, and income tax deductions, credits, and exemptions for employment creation, capital investment, or income creation in the zones."[22]

Thus, for businesses that operate – and only to the extent they operate – within specified areas, Alabama, for example, authorizes local governments to set up enterprise zones, with a "reduction of municipal tax rates, municipal license rates and/or municipal fees for governmental services within such zones."[23] Arizona allows income tax credits.[24] Arkansas permits refunds of sales and use taxes.[25] California permits credits against sales or use taxes imposed on the purchase of property.[26] Kentucky allows exemptions for sales and use, motor vehicle usage, and

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[21] *Id.* Although here we discuss only state laws using tax incentives for economic development, there are federal equivalents. *See* Dept. of Housing & Urban Development, TAX INCENTIVE GUIDE FOR BUSINESSES IN THE RENEWAL COMMUNITIES, EMPOWERMENT ZONES, AND ENTERPRISE COMMUNITIES, FY 2001, available Feb. 14, 2003, at http://www.ezec.gov/.

[22] *Id.*

[23] ALA. CODE § 11-40-16(b)(1) (1975).

[24] ARIZ. REV. STAT. ANN. § 41-1525 (1992).

[25] ARK. CODE ANN. § 15-4-1704(a)(1) (Lexis-Nexis Supp. 2001).

[26] CAL. REV. & TAX. § 23612.2(a) (West Supp. 2003); CAL GOV'T §§ 7070 *et seq.* (West Supp. 2003).

corporate income taxes.[27] Maryland permits credits against property and income taxes.[28] Minnesota permits a reduction in sales, income, and property taxes.[29] Missouri permits a credit against income tax.[30] Ohio permits an exemption for property taxes.[31] Oregon permits exemptions to property taxes.[32] Utah permits credits towards income and corporate franchise taxes.[33] Even Iowa has such zones, allowing companies operating there a credit against their corporate income tax liability.[34] In each instance, again, the tax benefits are allowed only for those operating within the precise geographic limits of the designated zone.

States are now building on that concept, using geographically-specific credits to assist areas whose troubles are not defined solely in economic terms. A recent enactment shows the creativity this concept allows: Maryland now

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[27] KY. REV. STAT. ANN. §§ 154.45-090(2), (4)-(7) (Michie 1998).

[28] MD. ANN. CODE art. 83A, §§ 5-404(a)(1)-(2) (Lexis-Nexis Supp. 2002).

[29] MINN. STAT. § 469.171, subd. 1(1)-(4) (2002).

[30] MO. REV. STAT. § 135.225.1 (2000).

[31] OHIO REV. CODE ANN. §§ 5709.62(c)(1)-(3) (West 1999).

[32] ORE. REV. STAT. §§ 285B.698(1)-(6) (1999).

[33] UTAH CODE ANN. § 9-2-413(1) (Lexis-Nexis Supp. 2002).

[34] IOWA CODE ANN. § 15.A9(4) (West Supp. 2002).

provides a personal property tax credit only for those "practicing dentistry in a geographic area of the State that has been designated by the Secretary of Health and Mental Hygiene as being underserved by dentists."[35]

The Maryland dentistry credit and the various States' enterprise zone credits are tax differentials that invoke geographic criteria of the same sort the Iowa Supreme Court attacks. After the allowed credits are taken into account, "the same activity is being taxed at significantly different rates" based on "a mere difference in location." Pet. App. 8. Manufacturing widgets inside or outside the enterprise zone may be "equally important in terms of revenue production." Pet. App. 9. Yet the States differentiate between the manufacturing plant on one block and the one on the next, just outside the zone. Similarly, dentists throughout Maryland providing the same services using the same equipment pay a single tax rate – unless eligible, by virtue of location, for a tax credit enacted as a means of promoting the practice of dentistry where it is most needed.

III. To preserve the States' ability to tailor their tax systems to garner adequate revenues and to promote economic development in the areas of greatest need, this Court should rein in judicial efforts to extend the courts' involvement into setting the precise boundary between two areas subject to different tax rates or eligible for different tax credits.

It will seldom, if ever, be possible to justify, under the Iowa approach, the placement of the boundary of an "enterprise zone" on 1st Street, instead of 2nd, or the authorization of a tax

[35] MD. CODE ANN. TAX-PROP. § 9-237.

in the geographic area to the west of Main Street, and not to the east, or denying a tax credit to one dentist while granting it to another just down the street. Yet legislatures have drawn such lines since before the beginning of the Republic – without judicial interference of the kind we see in this case.

As the petitioner points out, the federal concept of equal protection has never been equated with the requirement that the states yield "'to an iron rule of equal taxation.'"[36] Near the end of the 19th Century, this Court observed in *Bell's Gap Railroad Co. v. Commonwealth of Pennsylvania* that if the Fourteenth Amendment were to impose such an iron rule, the rule "would render nugatory those discriminations which the best interests of society require; which are necessary for the encouragement of needed and useful industries, and the discouragement of intemperance and vice; and which every State, in one form or another, deems it expedient to adopt."[37] Near the end of the 20th Century, the Court observed in summary that "[n]o scheme of taxation, whether the tax is imposed on property, income, or purchases of goods and services, has yet been devised which is free of all discriminatory impact."[38] At the beginning of the 21st Century, the same rule should apply.

Courts still lack – as this Court has noted in *Madden v. Kentucky* – the familiarity of a legislature with local conditions

[36] Brief for Petitioner, p. 24 n.1, *quoting Bell's Gap R.R. Co. v. Commonwealth of Pennsylvania*, 134 U.S. 232, 235 (1890).

[37] *Bell's Gap R.R.*, 134 U.S. at 237.

[38] *San Antonio Indep. Sch. Dist. v. Rodriguez*, 411 U.S. 1, 40-41 (1973).

that impact the setting of tax rates.[39] Thus, this Court, and others, have historically afforded state legislatures great deference in setting taxes.[40] Indeed, this Court has "often admonished against" judicial interference in the states' fiscal policies under the Equal Protection Clause.[41]

The judiciaries of the states do not, at present, follow the Iowa approach. They generally defer to legislative classifications in the tax context, in the face of equal protection challenges.[42] The Idaho Supreme Court aptly summarized the prevailing rule: "The fit need not be perfect, and the legislative scheme 'does not offend the constitution simply because it is

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[39] *Madden v. Kentucky*, 309 U.S. 83, 87-88 (1940).

[40] *Id.*

[41] *San Antonio Indep. Sch. Dist.*, 411 U.S. at 40-41.

[42] E.g., *John Hancock Mut. Life Ins. Co. v. Comm'r of Revenue*, 497 N.W.2d 250, 253 (Minn. 1993); *Communications & Cable of Chicago, Inc. v. City of Chicago*, 668 N.E.2d 1032, 1041 (Ill. Ct. App. 1996); *City of Prattville v. Welch*, 681 So. 2d 1050, 1053 (Ala. 1996); *Howard v. City of Fort Smith*, 845 S.W.2d 497, 499 (Ark. 1993); *Tucson Newspapers Inc. v. City of Tucson*, 837 P.2d 180, 186 (Ariz. Ct. App. 1992); *Eastern Air Lines, Inc. v. Dep't of Revenue*, 455 So.2d 311, 314 (Fla. 1984); *Sheppard v. State*, 650 P.2d 643, 646 (Idaho 1982); *Wesley Medical Center v. McCain*, 597 P.2d 1088 (Kan. 1979); *Michael J. Maloof & Co. v. Bureau of Revenue*, 458 P.2d 89 (N.M. 1969); *Oil Heat Institute of Washington v. Town of Mukilteo*, 498 P.2d 864 (Wash. 1972).

not made with mathematical nicety or because in practice it results in some inequality.'"[43]

The radical departure from the historical approach that the Iowa decision advances is particularly worrisome given the complex problems the states' legislatures are facing today. The cost of maintaining state and local government has increased almost every year of this country's existence.[44] But today, nearly every state is facing a fiscal crisis.[45] Permitting courts to second-guess legislative decision making in the tax context in the fashion endorsed by the Iowa Supreme Court would place the States on the path to fiscal chaos.

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[43] *Sheppard v. State*, 650 P.2d at 648, *quoting School Dist. No. 25 v. State Tax Comm'n*, 612 P.2d 126, 131 (Idaho 1980).

[44] James M. Dailey, *Casenote and Comment: The Thin Line Between Acceptable Disparate Tax Treatment of Nonresidents and Unconstitutional Discrimination Under the Article IV Privileges and Immunities Clause*, 21 HAMLINE L. REV. 563, 577 (Spring 1998).

[45] *See* note 1 and accompanying text, *supra*.

CONCLUSION

For the reasons stated above, the decision of the Iowa Supreme Court should be reversed.

Respectfully submitted,

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